

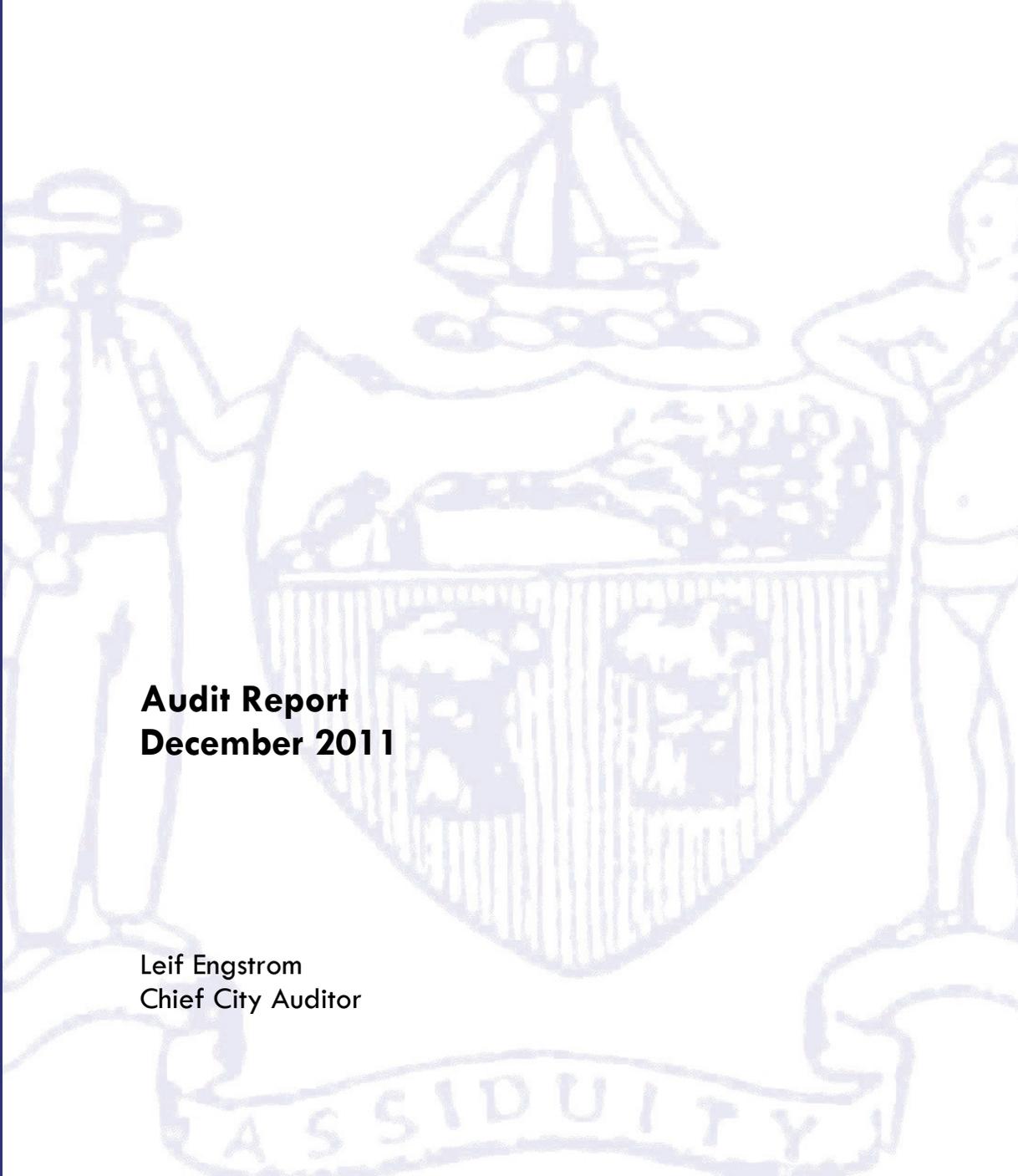
CITY OF ALBANY

Office of Audit and Control

Performance Audit of the City's **Cash and Investments**

Audit Report
December 2011

Leif Engstrom
Chief City Auditor



Audit Team

Leif Engstrom, Chief City Auditor

Debra Perks, Deputy, CIA, CGAP

Abigail Fox, Analyst

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PREFACE

The Office of Audit and Control exists to provide oversight, transparency and public accountability as a means to improve City services. This performance audit is a part of that function.

When the Office of Audit and Control takes on an audit client and, absent evidence of misconduct, that client addresses the audit's findings; it is our commitment to support and encourage their use of the audit process to improve their operations.

This audit was conducted with the cooperation of the Treasurer's Office Staff and the Treasurer has committed to addressing its findings.

The proper use of the audit findings in these circumstances is to provide for oversight of the resulting changes and as the basis for informed public policy discussions.

Given that this is a favorable audit and the Treasurer's Office has given their full cooperation, it would be unfair and damaging to the audit process for this audit's findings to be used for political gain. As such, the Office of Audit and Control will view the political use of this audit's findings as detrimental to our mission.

We thank the Treasurer's Office for their cooperation and commitment.

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The City's Investments are generally well managed; with the best available rates, proper collateralization, and policies that follow City and State requirements.

Executive Summary

This audit was initiated in response to a City Charter requirement that the Office of Audit and Control (OAC) audit the City's investments. This audit was not initiated as a result of OAC's citywide risk assessment process. As a result of the determinations made in this audit, OAC will fulfill this Charter-mandated duty again in 2013.

The audit team found that the City's investments are generally well managed. We based this determination on the following conclusions:

- The investment policy is in compliance with the City Charter and the procedures are in compliance with that policy.
- Funds meet the New York State collateralization requirements.
- The City's interest-bearing accounts yield the best available interest rates.

In conducting this audit, the audit team did identify two findings that resulted in two recommendations. The primary causes for the findings were a lack of personnel, staff turnover and recent reassignments of duties due to a change in the City Charter.

In addition to the two findings, we made three observations that, if addressed, could result in better and more secure financial operations. The findings and observations are as follows:

Finding 1: Treasurer's staff was unable to readily determine whether the Security and Collateral Agreements (SCA) on file were the current version. Three of the City's SCAs are authorized by Persons who no longer represent the City.

Recommendation 1: The Treasurer's Office should maintain SCAs on file and update them when the Authorized Person ceases to be an Authorized Person.

Finding 2: There were errors in the 2011 Bank Statement reconciliations for the General Fund and Payroll Fund.

Recommendation 2: All bank reconciliations should be reviewed regularly by a supervisor. Additionally, the Treasurer should approve all adjusting entries greater than \$10,000.

Observations

1. While the City's SCAs meet the New York State requirements, those requirements allow mortgage related securities and corporate bonds to be used as collateral. Events of the past two decades provide many examples of these types of securities becoming nearly worthless with little warning. In the
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New York State collateralization requirements may not provide sufficient security for the City's accounts. The City's SCAs should be reviewed to reduce risk.

event of a bank failure, the likelihood that these securities would lose significant value is higher. We advise the Treasurer to review the City's SCAs and amend them to only include very low risk securities.

2. There is a non-interest bearing account that receives federal funds reimbursing the City for expenses already paid from the general fund. Most of this money is available for transfer to an interest bearing account. Currently these funds are transferred annually but monthly transfers would provide the City with interest revenue (in 2011, about \$7,000).
3. Key Bank maintains a list of outstanding checks issued by the City and the list is used in the management of the City's cash flow. The Key Bank list includes obsolete checks that are stale dated or have either been voided or replaced by the City on the general ledger. Upon cursory review, the October KeyBank Payroll Account outstanding check list included \$43,639.11 of checks that had been voided on the general ledger. Updating the KeyBank outstanding check list to reflect changes on the General ledger would provide for improved cash flow management.

The audit team thanks the personnel who assisted and cooperated with us during this audit.

Definitions

In order to make this report more accessible to the lay reader, we have included a definitions page for financial terms that may not be widely understood. The definitions are in the context of the City's finances.

Adjusting Entry – entries in the General Ledger made during bank statement reconciliation to allocate receipts and disbursements to the period in which they actually occurred or the account to which they correctly belong.

Bank Statement reconciliation – the process of comparing the Bank Statement balance against the General Ledger account balance and indentifying differences.

Cash funds – the money kept on hand to meet short-term and emergency funding needs.

Cash and cash items – cash and any check given immediate credit to a customer's account before a bank has received payment from the paying bank.

Cash equivalent (investment) accounts –Cash and cash equivalents are the most liquid assets found within the asset portion of an entity's balance sheet.

Collateral – items pledged as security for deposited or invested funds that are not covered by FDIC deposit insurance.

Collateralized – an account is collateralized when securities are pledged as collateral for deposited or invested funds. All City accounts that exceed FDIC insurance limits are collateralized to protect the City in the event of a bank failure.

Collateral reports – monthly reports detailing the descriptions and market value of securities pledged as collateral for deposited or invested funds.

Deferred revenue – money received for services which have not yet been delivered.

General Fund – bank accounts for all financial resources except those required to be accounted for in another fund.

General ledger – the City's internal accounting records.

Investments –deposits into interest bearing accounts or obligations.

Outstanding checks – checks issued by the City, but not cashed.

Payroll Fund – bank account for funds held purely in a custodial capacity for payroll.

Reconciling adjustments – adjustments needed to balance the bank accounts to the general ledger.

Security and Collateral Agreements (SCA) -a contract that governs the relationship between the parties to a kind of financial transaction known as a secured transaction. The Security Agreement addresses issues such as acceptable types of securities held as collateral for deposited funds.

Stale dated –outstanding checks that are 90 days old or older.

Temporary investments – an investment designed to be held for a short period of time, typically a year or less.

Introduction

“A sound program for protecting public funds requires prudent strategies, including procedures to ensure the safety of investments and deposits while maximizing earnings on any money that is not required for operations.”

-Investing and Protecting Public Funds; Office of the New York State Comptroller

As the City’s chief fiscal officer, the City Treasurer is responsible for the collection, receipt, care and custody of all taxes and other monies due the City, except as otherwise provided by law¹. Under these duties, the Treasurer is responsible for the deposit of all monies received by the City and those deposits must be made in accordance with City and State law. The Treasurer is also responsible for making all investments of City funds in accordance with the rules set by the New York State General Municipal Law.²

In New York State, local governments have a limited number of investment options available to them. Local governments are authorized to invest money temporarily in:

- Time deposit accounts in a “bank” or “trust company” located and authorized to do business in New York State. Time deposit accounts are interest bearing, for example, interest bearing checking accounts and money market deposit accounts.
- Certificates of deposit (CDs) issued by a “bank” or “trust company” located and authorized to do business in New York State. CDs are purchased for specific periods of time that may be as short as seven days or as long as a year or more.
- Certain types of obligations such as bonds, notes or other such forms of indebtedness issued by certain specific entities such as the United States Government and the State of New York.

All investments with bank or trust company must have adequate collateral to secure the City’s investments that are not insured by the FDIC, and thus at risk in a bank failure or other event of default.

The City of Albany currently invests its money in interest bearing checking accounts, money market accounts, and CDs. At this time the City has no money invested in bonds or notes. In addition to its investments, the City deposits money into non-interest bearing checking accounts, which are currently insured by the FDIC and do not require additional security.

The purpose of this audit is to review the compliance of cash and investment activity in accordance with the Treasurer’s investment policy, the City of Albany Charter, and the laws and regulations of New York State.

¹ One notable exception is the Police seized assets account, which is managed by the Police Chief.

² The Treasurer is also responsible, once authorized by the Office of Audit and Control, for the payment of all vouchers, claims, payroll and other disbursements.

Background

Prior to 2010, the City Comptroller was the chief fiscal officer and responsible for the management of City funds as authorized by state law, including the authorization for payment of all vouchers, claims, and payroll and the maintenance of City accounts. Other responsibilities included internal auditing for City accounts, claims processing and debt management services. Effective January 1, 2010 the City Comptroller's office was replaced by the Office of Audit and Control (OAC), headed by the Chief City Auditor. At the same time, the duties of the chief financial officer were transferred to the Treasurer's office.

The principal duties of the OAC are to conduct performance audits of all City departments and offices; to audit all investments made by the City Treasurer on behalf of the City; and to warrant as valid all accounts payable claims prior to payment by the City Treasurer.

All activity on the 2011 investments, deposits, collateral, and bank reconciliations were performed by the Treasurer's office staff. The Office of Audit and Control staff was not involved in any duties of the areas reviewed in this audit and had not been for more than a year before the initiation of the audit.

Scope, Objectives, and Methodology

Scope

The scope of the investment audit is the review and examination of the investment and bank accounts, all collateral reports, related general ledger accounts and related records for the period of January 2011 through August 2011.

Objectives

1. Determine whether the actual procedures are in compliance with the City Charter and the Investment Policy.
2. Examine the rates and interest earned.
3. Determine whether the funds are properly collateralized.
4. Assess the cash balances in non-interest bearing accounts.
5. Determine whether the general ledger cash balances represent all *cash and cash items* on hand, in transit to or in financial institutions and that cash and cash items are properly recorded.

Methodology

The audit team reviewed cash balances on the general ledger to assure that all cash items on hand, in transit, are in appropriate financial institutions and properly recorded, and that all investments and cash funds are properly collateralized. We also reviewed reconciliations of the investment and bank accounts to the general ledger and reviewed the cash and cash equivalents activity for each month in the audit period. For the liquid assets (cash) we reviewed information on the bank reconciliations and the collateral reports. The general ledger detail was reviewed to ensure that all cash items were properly represented and recorded. Collateral reports and SCAs were reviewed to determine proper coverage of deposited funds.

For the City's cash equivalent (investment) accounts, the figures in the City's general ledger were checked to the appropriate supporting documentation from the financial institution to ensure proper representation and recording. The institutions were reviewed to ensure compliance with the City's investment policy.

We reviewed the responsibilities of the staff involved with investments.

This performance audit was conducted in accordance with generally accepted government auditing standards (GAGAS) issued by the U.S. Government Accountability Office (GAO.) Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions.

The Chief City Auditor warrants valid all vouchers, claims, payroll and other authorized disbursements. This is a Charter-mandated nonaudit service that impairs independence in regards to all audits performed by the Office of Audit and Control.

Audit Results

1. The investment policy is in compliance with the City Charter and the procedures are in compliance with the policy.
 - a. The Investment Policy was adopted by the Treasurer in the spring of 2011.
 - b. The Investment Policy states that the Treasurer annually prepares an investment report summarizing investment results, and providing detail on the type, term, interest rates and yields of the City's investments during the prior year. The scope of the next audit will include the report for 2011.
 2. Rates and interest earned on interest-bearing accounts are the best rates available and the investments are in compliance with the investment policy and general municipal law.
 3. Funds were adequately collateralized for every account except for an account with First Niagara in May. The account was opened in May and when the Deputy Treasurer reviewed the collateral and found it was under collateralized by \$17,505,371.86, he immediately contacted First Niagara. The collateral was corrected and a 6/6/2011 collateral report was issued to the City showing adequate collateral. Since 6/6/2011 (before the start of this audit) the City has maintained adequate collateral on all bank accounts.
 - a. While the First Niagara account was under-collateralized for less than a month, this incident provides reassurance that the collateralization reports are monitored and that errors are corrected on a timely basis.
 - b. **(Finding 1)** Only the Security and Collateral Agreement (SCA) for First Niagara was identifiable as a current SCA. Due to a change in personnel, the Treasurer's staff could not determine whether the older records on file were the current SCAs. The financial institutions were contacted for copies and it was determined that the older SCAs on file are current. The security and collateral agreements for Chase, KeyBank, HSBC, and M&T Bank were missing. All SCAs were eventually obtained and provided for review. Chase (Chemical) Bank (dated 1995 and signed by Nancy Burton), KeyBank (dated 2/25/2003 and signed by Tom Nitido), M&T (dated 7/9/1998 and signed by Nancy Burton) security and collateral agreements should be updated.
 - c. **(Observation 1)** While the City's SCAs meet the New York State requirements, those requirements allow mortgage related securities and corporate bonds to be used as
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collateral. Events of the past two decades provide many examples of these types of securities becoming nearly worthless with little warning. In the event of a bank failure, the likelihood that these securities would lose significant value is higher. We advise the Treasurer to review the City's SCAs and amend them to only include very low risk securities.

4. **(Observation 2)** There are six noninterest bearing accounts. Of the six accounts the only one that has funds available for transfer to an interest bearing account is the GD0200 / Federal Miscellaneous Keybank account. Funds in this bank account have primarily been received as reimbursement for expenditures paid by the general fund bank account and could be regularly transferred to general fund to be used as operating funds. This would positively affect the cash flow and liquidity analysis used to determine funding amounts. The deferred revenue portion of \$252,063.25 would be left in the Federal Miscellaneous noninterest bearing account. The funds in that account as of 11/16/2011 of \$2,975,138.14 less the \$252,063.25 leaves \$2,723,075 available to be transferred into the General Fund or a Money Market bank account. The projected annualized interest on the funds at .40% if they were deposited monthly into the highest yield money market account used by the City in 2011 is approximately \$7,000.
 5. Upon review of the monthly bank reconciliations three issues were found.
 - a. **(Finding 2)** Bank reconciliations performed by staff were not reviewed by a supervisor for accuracy and completeness of adequate documentation support for adjustments. Some reconciling adjustments were not accurate and other differences were not identified or corrected. Supervisory review would ensure that corrections are processed for the general ledger or bank account.
 - b. **(Finding 2 Cont'd)** The Property Tax bank account statements were not included with the General fund bank reconciliation. The Property Tax bank account is a KeyBank account for the receipt of internet payments for payment of property taxes. Daily payments were recorded on the City's General ledger, but the funds were not transferred by the end of the month to the General Fund bank account. The majority of the activity in the Property Tax bank account was in January. The fiscal analyst responsible for reconciling the General Ledger cash account A0200 to the General Fund bank statement should have access to the Property Tax bank account monthly statements. This is because funds from both the General Fund bank account and the Property Tax bank account are recorded on the general ledger cash account A0200 and both bank statements are necessary for proper reconciliation to the general ledger.
 - c. **(Observation 3)** KeyBank maintains a list of *outstanding checks* for the City. The outstanding check lists for both the General Fund bank account and the Payroll Fund bank account include obsolete checks that are *stale dated* or have either been voided or replaced by the City on the general ledger. The KeyBank outstanding check lists need to be updated to reflect changes on the General ledger. Upon cursory review of the October KeyBank Payroll Account outstanding check list, \$43,639.11 of the outstanding checks still open on the KeyBank list was voided on the City's General ledger as of 9/30/2011.
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Finding 1:

Treasurer's staff was unable to readily determine whether the Security and Collateral Agreements (SCA) on file were the current version. The First Niagara agreement which was dated May 2011 was the only one identifiable as current. Three of the agreements are with Authorizing Persons who no longer represent the City.

Condition: SCAs have not been updated for Authorized Persons and agreements were not identifiable as current.

Criteria: SCAs should be on file in the office responsible for ensuring adequate collateral for deposited funds and the agreements should be updated when there is a change of Officers for the City.

Effect: If the agreements are not readily used for reference and review, then a change of personnel could result in inadequate review of the collateral reports for legal securities and adequate collateral coverage of deposited funds. The agreements could be compromised if they are not updated for Authorized Persons.

Cause: The restructuring of the City Treasurer's office and the City Comptroller's office into the City Treasurer's office and the Office of Audit and Control (OAC) involved changeover in both staff and responsibilities. In addition, two of the supervisory personnel left and responsibilities had to be rearranged. Responsibility for the maintenance of the file was not clarified during these changes.

Recommendation: Maintain Security and Collateral agreements on file in the office responsible for ensuring the appropriateness of the securities and adequate collateral for deposited funds. Update all Security and Collateral agreements when the Authorized Person ceases to be an Authorized Person or in the event that any other Authorized Persons are appointed and authorized.

Finding 2:

There were errors in the 2011 Bank Statement reconciliations for the General Fund and Payroll Fund.

Condition: Although most of the general ledger or bank account errors were found and corrected, the reconciliations contained reconciling items that were not accurate, or were not supported with documentation or explanations of the reconciling adjustment. The reconciliations were not reviewed by a supervisor or a qualified staff person. Additionally, the Property Tax bank account statements (for internet payments) were not included with the General fund bank reconciliation.

Criteria: Work done by staff should be reviewed by a supervisor or other qualified staff person for completeness and correctness.

Effect: Some items may not have been properly identified for correction on the City's general ledger accounts or bank accounts, with the potential damage cash flow management. There is also the potential that Treasurer's Office management would not be aware of material adjustments.

Cause: The restructuring of the City Treasurer's office and the City Comptroller's office into the City Treasurer's office and the OAC involved changeover in both staff and responsibilities. The change added a significant new responsibility (performance auditing) without additional personnel. These events and realities may have contributed to lower prioritization in the monitoring of certain activities.

Recommendation: All bank reconciliations should be reviewed and signed regularly by a supervisor, and signed by the Treasurer for any adjusting entry of \$10,000 or greater. Adjustments should have supporting documentation and explanation. Additionally, the Property Tax bank account statements should be included with the General fund bank reconciliation.

APPENDIX 1-A

Management Response



**CITY OF ALBANY
OFFICE OF THE TREASURER
ROOM 109
24 EAGLE STREET
ALBANY, NEW YORK 12207
TELEPHONE (518) 434-5036**

**KATHY M. SHEEHAN
CITY TREASURER**

Memorandum

To: Leif Engstrom, City Auditor
From: Kathy M. Sheehan, City Treasurer
Re: Response to Performance Audit dated December 2011
Date: December 7, 2011

In accordance with the Albany City Charter, the Office of Audit and Control (OAC) conducted an audit of the City's cash and investments. As noted in the audit, the Treasurer's Office cooperated in this audit and has committed to addressing its findings.

The audit contained two findings and three observations, which we address more fully below.

Response to Finding 1: All deposits of the City are fully collateralized in accordance with Section 10 of the New York State General Municipal Law and the City's Funds Management and Investment Policy. In order to become a depository of City funds, banks must execute a Security and Collateral Agreement (SCA) with the Treasurer's Office.

It is important to note that SCA's signed by the previous authorized representative of the Treasurer's Office remained legally binding with respect to all affected deposits (i.e., the contract did not become void simply because the person who executed it no longer worked for the City). Notwithstanding this fact, we agree that when the Treasurer's Office changed the authorized signer for purposes of depositing and transferring funds, it should have reviewed and re-executed all applicable SCA's. The City's Law

Department is in the process of reviewing new SCA's for the three accounts identified in the audit and they will be executed by the current Treasurer upon approval.

Response to Finding 2: In 2011, the Treasurer's Office created a new position of Accountant II, but did not immediately fill it. This position was created to support the Deputy Treasurer, including review of bank reconciliations as recommended in the audit. Applications for this position are due by December 12, and the office expects to have an Accountant II on staff by early January.

Over the next six months we will develop more detailed written procedures regarding bank reconciliations and review. We will provide a copy of those procedures to the OAC prior to final adoption. Until those procedures are fully adopted, we will implement the recommendations of the audit.

Response to Observation 1: We recognize that all of the eligible securities authorized as acceptable collateral by the Office of the State Comptroller pose some risk in the event of default. In addition, irrevocable letters of credit and surety bonds also pose risks. We are in the process of reviewing eligible securities under each of our SCA's. We will make any changes that we deem prudent.

Response to Observation 2: We will review the account identified in the audit monthly and transfer funds that have been released to the City under the applicable funding agreement to an interest bearing account.

Response to Observation 3: We agree that checks that have been voided on the City's general ledger should be cancelled from the applicable Key Bank accounts. Typically, this is done on a weekly basis, but we will draft a written procedure addressing this issue as part of our response to Finding 2.

We appreciate the thoroughness of the audit and the professionalism of the staff of the Office of Audit and Control. We look forward to providing the OAC with any additional information it may request regarding the City's investment policy and cash management.